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No. 90-984

In the Supreme Court of the United States

OCTOBER TERM, 1990

KANSAS GAS AND ELECTRIC COMPANY, PETITIONER

v.

KANSAS STATE CORPORATION COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE STATE OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether the Kansas Corporation Commission violated the Supremacy Clause when, for purposes of setting rates for petitioner's retail customers, it imputed revenue to petitioner in connection with an off-system, interstate sale of power subject to FERC's jurisdiction under Title II of the Federal Power Act.

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This brief is submitted in response to the Court's order inviting the Solicitor General to file a brief expressing the views of the United States.

STATEMENT

Petitioner seeks further review of an order, issued by respondent State Corporation Commission of Kansas (KCC), concerning the rates petitioner may charge its retail customers for electric power. Petitioner asserts that KCC's treatment of an off-system sale of power to an Oklahoma utility infringed upon FERC's exclusive jurisdiction, under Title II of the Federal Power Act, 16 U.S.C. 824 *et seq.*, over interstate wholesale sales of power.

1. Petitioner owns a 47% interest in the Wolf Creek Nuclear Generating Station (Wolf Creek), a nuclear power plant capable of generating approximately 1,150 megawatts (MW) of electricity. Like many other nuclear plants, Wolf Creek proved far more expensive to build than was originally anticipated. In 1973, the cost of construction was estimated at $525 million. By the time the plant was completed, however, its cost had climbed to more than $3 billion. To make matters worse, the demand for power when the plant came on line fell well below earlier projections. Pet. App. 26a; Pet. 5; KCC Br. in Opp. 2 n.1.

a. In 1984, petitioner filed an application for a rate increase to recover the costs of Wolf Creek. The application sought an increase sufficient to make up an anticipated $373 million annual shortfall in the utility's revenues. In 1985, KCC issued orders providing for a series of rate increases designed to produce the equivalent of $169.6 million per year. Much of the difference between petitioner's request and the amounts awarded by KCC was attributable to KCC's finding that a substantial proportion of Wolf Creek's capacity was excess capacity, the full cost of which could not be passed on to petitioner's retail customers. Pet. App. 26a, 144a; *In re Wolf Creek Nuclear Generating Facility*, 70 P.U.R. 4th 475, 515-516 (Kans. Corp. Comm'n 1985).

The 1985 orders did allow petitioner to include 46 MW of the capacity in Wolf Creek in its rate base to compensate for the retirement of petitioner's 92 MW Ripley Station. Those orders also provided that an additional 46 MW of Wolf Creek capacity could be added to the rate base if petitioner demonstrated that it was prudent to retire the Ripley plant. *Wolf Creek*, 70 P.U.R. 4th at 514. See Pet. 5 n.6.

Petitioner sought judicial review of the 1985 ratemaking orders. The Kansas Supreme Court affirmed the orders. *Kansas Gas & Electric Co.* v. *State Corp. Comm'n*, 239 Kan. 483, 720 P.2d 1063 (1986). Petitioner appealed to this Court, arguing that the rates mandated by the 1985 orders were confiscatory. This Court noted probable jurisdiction. 479 U.S. 1082 (1987).

b. In March 1987, KCC approved petitioner's application to retire the Ripley plant. The same month, KCC entered an order, referred to as the Rate Stabilization Order, that modified the 1985 orders in a number of respects. Among other things, the Rate Stabilization Order provided, subject to one condition, for the inclusion of the additional 46 MW of Wolf Creek capacity in the rate base to replace retired Ripley capacity. The condition was that petitioner demonstrate that the need for Wolf Creek capacity had grown by 41 MW between 1986 and 1988, as a result of either additional demand or reduced overall generating capacity. The Rate Stabilization Order provided that, if that showing could be made, the resulting modification in petitioner's rates would take effect in January 1989. It was later determined that the inclusion of the Wolf Creek capacity in the rate base would produce an additional $14.4 million in revenue. Pet. App. 28a-29a, 134a-135a.

KCC brought the Rate Stabilization Order to this Court's attention and argued that it made the constitutionality of the 1985 orders moot. This Court dismissed petitioner's then-pending appeal on that ground. 481 U.S. 1044 (1987).

c. In December 1988, KCC conducted a hearing on the question whether the need for Wolf Creek capacity had grown by the requisite 41 MW. KCC found

that petitioner "had exceeded the 41 MW capacity increase required" for the $14.4 million rate increase. Pet. App. 104a. However, at the same time, KCC granted a motion by respondent Citizens' Utility Ratepayers Board (CURB) to make the increase "interim, subject to refund" and directed KCC's staff to conduct an audit of petitioner's rates. *Id.* at 105a. KCC explained (*id.* at 105a-106a):

> During the past four years the Commission has attempted to achieve equitable solutions to the problems associated with bringing Wolf Creek on-line. This has necessitated a sharing of the burdens and benefits associated with Wolf Creek between [petitioner] and its ratepayers. The Commission is concerned with the risk-sharing aspect of [petitioner's] rates. In order to determine if the appropriate level of risk-sharing is reflected in rates, especially in light of actions taken by [petitioner] since approval of the Rate Stabilization Plan, the Commission believes an audit of [petitioner's] rates is necessary.[1]

2. KCC's staff completed the audit in July, 1989. The staff concluded that the existing rate structure would produce a revenue deficiency of $18 million. The staff did not recommend a rate increase to cover that deficiency, but it did propose that the $14.4 million interim increase be made permanent. KCC set a hearing to receive evidence on that issue and on the audit in general. At the hearing, petitioner supported the staff's recommendation, although it took

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[1] After KCC had entered the order at issue here, the Kansas Court of Appeals reversed the December 1988 order to the extent that it made the $14.4 million rate increase interim and subject to refund. *Kansas Gas Electric Co.* v. *State Corporation Comm'n*, No. 63,400 (June 4, 1990).

issue with the audit's treatment of some particular items. CURB proposed a number of adjustments that would increase petitioner's operating income above the figure produced by the audit, in an attempt to provide a basis for reduced rates to petitioner's retail customers. Pet. App. 29a-30a, 33a-34a.

Some of CURB's proposed adjustments involved imputing revenue to petitioner in connection with sales of electricity at rates below those at which Wolf Creek Power could be produced. One such adjustment involved petitioner's sale of 41.2 MW of capacity to the Oklahoma Municipal Power Authority (OMPA). In May 1986, petitioner entered into an agreement with OMPA to provide this capacity from two of petitioner's gas-fired plants. This gas-fired capacity was much less expensive than equivalent Wolf Creek capacity. The contract was filed with FERC, as required by the Federal Power Act, 16 U.S.C. 824d(c). There was no challenge to the agreement, and it took effect in July 1986. Pet. App. 56a, 163a, 166a-182a.

CURB argued that because petitioner had relied on this sale in demonstrating that the need for Wolf Creek capacity had increased by 41 MW between 1986 and 1988 and had thereby been permitted to include additional Wolf Creek capacity in the rate base, the sale's effect was to substitute high-cost Wolf Creek capacity for low-cost gas-fired capacity in petitioner's rate base. To counteract the effect of that substitution, CURB urged that $13.5 million in revenue (the difference between the cost of 41.2 MW of Wolf Creek capacity and the cost of the gas-fired capacity actually used to satisfy the OMPA contract) should be imputed to petitioner. If adopted, the effect of such an adjustment would be to reduce, by that amount,

the sum that petitioner's retail customers would have to pay to produce total revenue sufficient to cover petitioner's approved costs and return on investment. See Pet. App. 56a.

In an order issued on May 13, 1990, KCC adopted the adjustment proposed by CURB. Pet. App. 56a-58a. KCC acknowledged that its action was unusual, but found an adjustment to be justified by "the novel circumstances in this docket." *Id.* at 58a. It explained (*ibid.*):

> This is not a simple sale of excess power by one utility to another. It is a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers. Even more importantly, this sale was used as justification for including that high-cost capacity in rates and the resulting interim rate increase at issue in this docket. [Petitioner] met part of the condition precedent established by this Commission for including the revenue impact of the Ripley retirement with [petitioner's] January 1, 1989, rate increase by increasing its capacity sales by 43 MW between 1986 and 1988. Included in those 43 MW is the 41.2 MW of capacity committed for 15 years to OMPA.

KCC made a comparable adjustment to revenues derived from low-cost sales of "interruptible" power to some of its customers. As with the OMPA transaction, KCC determined that an adjustment was warranted to mitigate the effect of those sales' having been used to justify the inclusion of Wolf Creek capacity in the rate base. See Pet. App. 51a-56a.

On the basis of these and other rulings, KCC ordered petitioner to reduce its rates by a total annual

amount of $8.677,386. Pet. App. 75a.[2] Petitioner sought reconsideration, arguing, *inter alia*, that KCC's treatment of the OMPA sale violated the Supremacy Clause. KCC denied the petition for reconsideration. Pet. App. 97a-101a.

3. Petitioner sought judicial review of KCC's order. In an unpublished decision, the Kansas Court of Appeals affirmed the adjustments imputing income to petitioner. With respect to the sale to OMPA, the court found that there was "substantial competent evidence" to support KCC's finding that the OMPA sale was used to satisfy the condition to the $14.4 million rate increase. Pet. App. 11a. The court also held that KCC's decision to impute revenue to petitioner on that basis did not transgress the filed rate doctrine applied in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988), or otherwise violate the Supremacy Clause.

The court explained that the filed rate doctrine "ensures that the buyer of the wholesale power is allowed to recover its approved costs from the ratepayer." Pet. App. 18a. In the instant case, the court continued, petitioner "is not the buyer of the wholesale power, but the seller" and "[t]he wholesale

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[2] Chairman Henley dissented. Pet. App. 80a-96a. With respect to the OMPA sale, he maintained that the majority's position contradicted representations made to this Court in KCC's motion to dismiss petitioner's prior appeal (see p. 3, *supra*); that the effect of the decision was to penalize petitioner for sales that prior orders had been designed to encourage; that the transaction fully compensated petitioner and was approved by FERC; and that the sale had not in fact been used to satisfy the condition to the inclusion of additional Wolf Creek capacity in the rate base.

rates paid by OMPA were not affected and OMPA was not prohibited from recovering the FERC-approved rates." *Ibid.* Because "FERC regulates the sale of wholesale power" and "[t]he KCC's actions in imputing revenue at Wolf Creek rates does not affect the FERC-filed rates," the court concluded, "the Supremacy Clause does not prohibit KCC's actions." *Id.* at 19a.

The Kansas Supreme Court denied petitioner's request for further review. Pet. App. 24a.

DISCUSSION

Petitioner argues that the imputation of revenue to the off-system sale of capacity to OMPA infringes upon FERC's exclusive jurisdiction over wholesale sales of electric power in interstate commerce. Notwithstanding the form of KCC's order, we do not agree with petitioner's characterization of the adjustment. As we understand KCC's order, the adjustment was ultimately based on the fact that petitioner had relied upon the OMPA sale to justify the inclusion of Wolf Creek capacity in petitioner's rate base. KCC determined, in essence, that it would be unjust to allow petitioner to take advantage of the sale for that purpose without also making an adjustment to mitigate the effect on petitioner's retail customers. As such, the order was merely one of a series of actions KCC has taken to allocate the costs of Wolf Creek capacity between petitioner's shareholders and Kansas ratepayers. The allocation of those costs is not subject to FERC's exclusive jurisdiction and was thus not off-limits to KCC. The fact that KCC expressed its decision in terms of an adjustment to the revenue realized from an interstate sale of

electric power does not, in our view, require a different conclusion. In any event, since the order at issue grew out of the particulars of KCC's prior orders, the case does not present a question of general importance calling for this Court's review.

1. In the order at issue, KCC emphasized the unusual nature of its adjustment and the particular circumstances on which it was based. KCC noted that although its adjustment to petitioner's revenues might be considered "novel," the adjustment was justified by "the novel circumstances in this docket." Pet App. 58a. Later in the order, KCC reiterated that its action was based upon the off-system sale's effect on the rates paid by petitioner's Kansas customers "under the very unique facts" of the case. *Ibid.*

The most important of those facts, KCC made clear, was the role that the OMPA sale played in the rate increase accompanying the retirement of the Ripley plant and the corresponding substitution of 46 MW of Wolf Creek capacity in petitioner's rate base. The majority of KCC determined that, in making the showing KCC had required as a condition precedent to that increase, petitioner had relied on the off-system sale to OMPA. Although a member of the KCC dissented from that determination, the state court found that it was supported by "substantial competent evidence." Pet. App. 11a. KCC emphasized that this circumstance was the fundamental basis for the adjustment. *Id.* at 58a ("Even more importantly, this sale was used as justification for including that high-cost [Wolf Creek] capacity in rates.").

Understandably, petitioner relies upon the form the adjustment took—an increase in revenue attrib-

uted to an interstate sale—in suggesting that the adjustment interferes with FERC's authority to oversee the rate charged in the OMPA transaction. However, when the order is read as a whole, it seems quite clear that the adjustment's essential function was, in the context of past KCC orders, to modify the allocation of the costs of the Wolf Creek plant between petitioner's shareholders and retail customers. The adjustment did not reflect any judgment regarding the merits of the interstate sale, nor did it embody any disagreement with the interstate rates filed with FERC.

2. FERC's jurisdiction does not extend to the allocation of the costs of excess Wolf Creek capacity between petitioner's retail customers and its shareholders. Under Section 201(b) of the Federal Power Act, 16 U.S.C. 824(b), FERC possesses exclusive jurisdiction over "the transmission of electric energy in interstate commerce and * * * the sale of electric energy at wholesale in interstate commerce." Section 205(c) of the Act, 16 U.S.C. 824d(c), requires public utilities to file "schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services." FERC has authority to determine whether any filed rate or contract is "unjust, unreasonable, unduly discriminatory, or preferential" and to substitute reasonable terms. 16 U.S.C. 824e(a). In a case where a transaction involves an allocation of power, "FERC's exclusive jurisdiction applies not only to rates but also to power allocations that affect wholesale rates." *Mississippi Power*, 487 U.S. at 371.

FERC's exclusive jurisdiction has several corollaries, which together have come to be known as the "filed rate doctrine." No party to an interstate wholesale sale of electric power has a right to a rate different from the one filed or determined by FERC. As this Court held in *Montana-Dakota Utilities Co.* v. *Northwestern Public Serv. Co.*, 341 U.S. 246, 251-252 (1951), "the right to a reasonable rate is the right to the rate which the Commission files or fixes, and * * * except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one." See also *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981). States must also accept as reasonable, for purposes of setting rates paid by retail purchasers of power, the rates adopted by FERC (by means of its acceptance of filings and adjudications), as well as determinations on which those rates are based. That result is "mandated by the Supremacy Clause." *Mississippi Power*, 487 U.S. at 371; *Nantahala*, 476 U.S. at 963-964.[3]

As long as States do not infringe upon FERC's exclusive jurisdiction, they retain their traditional

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[3] The filed rate doctrine is an application of the settled principle that where Congress has regulated comprehensively, so as to occupy the field encompassed by the statute, attempts by States to regulate in the field are preempted. See *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 300 (1988); *Northwest Central Pipeline Corp.* v. *Kansas Corp. Comm'n*, 489 U.S. 493, 509 (1989). Thus, application of the filed rate doctrine is not limited to case-by-case consideration of whether an attempt at state regulation is in conflict with an order of FERC. *Mississippi Power*, 487 U.S. at 374. See generally *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964).

authority to regulate the rates paid by retail purchasers of electricity. See generally *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. 375, 379-388 (1983). Subject to constitutional limits not put in issue by the petition, therefore, KCC had authority to determine how it would divide the costs of the Wolf Creek plant between petitioner's shareholders and its retail customers. In our view, the substance of the order at issue placed it on the State's side of the "bright line" (*Mississippi Power*, 487 U.S. at 374) between FERC's jurisdiction over petitioner's off-system sale to OMPA and KCC's jurisdiction over the treatment, for purposes of retail rates, of the costs of the Wolf Creek plant.

As noted, the adjustment at issue arose out of an arrangement in which the inclusion of Wolf Creek capacity in the rate base was made contingent on a showing of need for that capacity. The effect of the adjustment was not to undercut FERC's approval of the OMPA transaction. Significantly, the sale to OMPA did not arise out of an allocation of power mandated by FERC, and KCC's adjustment did not reflect a regulatory judgment that the price paid by OMPA for the gas-fired power it purchased was unreasonably low.

The KCC's members were in sharp disagreement over whether that judgment represented an unjust departure from prior orders regarding excess Wolf Creek capacity. See Pet. App. 88a-90a (Henley, Ch., dissenting). The proper resolution of that dispute, however, does not involve application of the filed rate doctrine or the Supremacy Clause. The filed rate doctrine serves ot protect FERC's exclusive jurisdiction over interstate wholesale transactions in electric

power, not to assure the regularity of state ratemaking proceedings.[4]

3. As petitioner notes, the Kansas court of appeals distinguished this case from *Nantahala* and *Mississippi Power* on the ground that petitioner was a seller, rather than a purchaser, of wholesale power. See Pet. App. 18a (*Nantahala* and *Mississippi Power* "simply do not address the effect of state regulation on the seller of the wholesale power that recovers the FERC-filed rate"). Focusing on this aspect of the court's opinion, petitioner suggests that this Court's review is warranted to determine whether and to what extent the filed rate doctrine applies to sellers. Whatever the merits of the state court's treatment of this Court's decisions, the fact remains that the rationale of those decisions does not reach this case. In our view, therefore, review is not warranted to consider the general issue of the filed rate doctrine's applicability to wholesale sellers of power.

As this Court has noted, the paradigm case for application of the filed rate doctrine is one in which a State finds a price paid by a utility for a wholesale

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[4] State authorities operate within broad constitutional constraints in setting rates. See, *e.g.*, *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 310-316 (1989); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).

Petitioner also suggests that the adjustment at issue was inconsistent with representations made to this Court that resulted in the dismissal of petitioner's prior appeal as moot. See Pet. 8-9. In our view, the representation that the March 11, 1987, Rate Stabilization Order established a permanent "fremework" (Pet. 8) for ratemaking over the life of the Wolf Creek plant did not forclose an adjustment of the type at issue. In any event, petitioner has not, at any stage of this case, renewed the claim before the Court in the prior appeal; that claim was that KCC's treatment of Wolf Creek costs was confiscatory.

purchase of power, although mandated by FERC, to be unreasonable for purposes of state ratemaking. In that situation, the filed rate doctrine "ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates." *Nantahala*, 476 U.S. at 970; *Mississippi Power*, 487 U.S. at 372.[5] A decision by a State that the FERC-mandated price for wholesale power was unreasonable, for purposes of ratemaking for retail customers, would undercut FERC's exclusive jurisdiction over interstate sales.

It is also true, however, that the filed rate doctrine is not invariably limited to this paradigm situation. In *Nantahala*, the utility involved was, in a sense, both a buyer and seller of power subject to FERC's jurisdiction. Nantahala generated power that it provided to TVA; in exchange, it received an allotment of TVA's low-cost "entitlement" power. Nantahala distributed the entitlement power to its wholesale and retail customers, making up the balance of its needs by purchasing higher-cost power at wholesale. FERC determined the amounts of entitlement power that would be allocated to Nantahala and an affiliate in the course of resolving a dispute over the rates Nantahala charged a wholesale customer. In a separate proceeding, state regulators concluded, in effect, that Nantahala should have received a larger share of the low-cost entitlement power, and, for purposes of

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[5] The Court explained in *Nantahala*, 476 U.S. at 970:

> When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a state may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate * * *. Such a "trapping" of costs is prohibited.

retail ratemaking, they revised Nantahala's costs to reflect their view of the proper allocation. As this Court noted, the case did not present "the typical application of the filed rate doctrine," since Nantahala was not just a purchaser of wholesale power distributed to retail customers. 476 U.S. at 969.

Nevertheless, the Court found, the filed rate doctrine required the State to observe FERC's allocation of entitlement power in fixing Nantahala's retail rates. Because Nantahala was legally bound by that allocation, the conflicting allocation employed by state authorities made it impossible for the utility to recover the full cost of the power it obtained at wholesale and supplied to retail customers. The Court explained (476 U.S. at 971):

> Nantahala must under [the State's] order calculate its retail rates as if it received more entitlement power than it does under FERC's order, and as if it needed to procure less of the more expensive purchased power than under FERC's order. A portion of the costs incurred by Nantahala in procuring its power is therefore "trapped."

The order in question in the instant case has none of the characteristics that triggered the application of the filed rate doctrine in *Nantahala*. Here, FERC does not have responsibility for establishing the extent to which petitioner may recover the costs of Wolf Creek power from petitioner's retail customers. FERC did not allocate petitioner's gas-fired capacity to OMPA, thereby obligating petitioner to sell its low-cost capacity off-system, nor did it allocate Wolf Creek capacity to petitioner. The adjustment does not interfere with petitioner's ability to collect the FERC-set rate from OMPA or OMPA's ability to

pass on that rate to its customers. The only "costs" trapped by the adjustment are those associated with operations other than those involved in the transaction regulated by FERC—including, in particular, those associated with Wolf Creek. But that financial impact is no different than the consequences that would have accompanied an order denying petitioner the right to include those costs in its rate base in the first place. Unlike the state order at issue in *Nantahala*, therefore, KCC's order does not embody a judgment regarding the appropriateness of the FERC-approved transaction, and its effect is not to require petitioner's shareholders to absorb the costs of FERC-mandated transactions.

Even if the state court read this Court's filed rate cases too narrowly, therefore, the fact remains that the principles applied in those cases do not foreclose the adjustment at issue.[6] In our view, this Court's review is not warranted to consider the merits of a

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[6] As petitioner notes, this case does not present the question—which is separate from the filed rate doctrine—of whether the state order violates the Commerce Clause. See Pet. 15-16 n.14 (discussing *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982)). While "the Commerce Clause * * * precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to products derived therefrom," 455 U.S. at 338, that constitutional provision also mandates a particularized assessment of the justification for a challenged action, the magnitude of putative local benefits of the action, and the burden imposed upon interstate commerce. *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. at 393-394. Petitioner did not rely on the Commerce Clause below; neither KCC nor the Kansas Court of Appeals addressed that provision; and the question presented in the petition does not refer to the Commerce Clause.

distinction drawn in the opinion below that is unnecessary to a proper disposition of the case. Moreover, the order in question was tied closely to the particular features of past orders addressing the costs of Wolf Creek. For these reasons, we do not believe that the decision upholding it presents a question of general significance calling for this Court's attention.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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